Debt/Credits

The main instrument of influence we have on the Polish Government (and the Soviet Union) involves existing debt and possible future credits.

The most immediate lever we have is on the rescheduling of Polish debt. Without rescheduling, Poland is likely to remain in de facto default. If Poland is finally declared in default, whether by a Western bank or by the US government, either the Soviets, Poles, or other Eastern Europeans would have to ante up about $7 billion this year, which would require increased oil and gold sales and perhaps increased Soviet borrowing from the West -- all painful actions -- or they would have to suffer the consequences of formal default. These consequences would include no normal foreign trade with Poland as long as it is in arrears and an increase in the risk premium charged to Eastern European borrowers, very likely including the Soviet Union. Moreover, formal default as well as the final puncturing of the "umbrella theory" would make it far more difficult for the Eastern European countries to regain access to credit in the longer term.

The main risk of formal Polish default for the West is not that a major bank (e.g., the Dresdner) will become insolvent but that major bank losses might ripple through the Euro-currency market causing difficulties for some other banks. Given the fact that formal default could be declared at any time it is urgent that contingency plans be in place for this possibility. It is hard to believe that the central banks can't prevent serious damage.

The State/Treasury position is that (a) formal default will let Poland/USSR off the hook of having to make payments and (b) we should maintain the threat of calling formal default as a deterrent. (The problem of consistency with this position has been much noted by other participants in the debate.) In reality, formal default would be costly and its threat value depends on our making it likely enough to be credible.

This analysis argues for taking steps that signal to the Poles and Soviets that we are moving towards formal default and that this is likely unless certain conditions are met including the release of prisoners and the restoration of Solidarity's rights.

Yamal

All agencies except State hold that the December 30, 1981 sanctions should apply not only to exports from the US but also to equipment made by foreign subsidiaries of US firms and by licensees. The issue of making an exception for controlled GE components already shipped or for the fulfillment of existing contracts or letters of intent has arisen particularly in the case of the UK where the estimated losses and layoffs are held to be especially painful. This position is rejected by all of the agencies (but the Vice President's representative supports it).

The key points here are that the Soviets might in part or in total try to switch to less satisfactory or unproven Rolls Royce turbines (RB-211s) which would, in addition, seem to require switching to a non-US compressor. If licensing problems could be overcome, the Soviets might try to get Alsthom-Atlantique to build compressors using the GE design, but there would probably be a delay of two or more years and there might also be problems in replicating GE's computerized controls.

Finally, the Soviets might rearrange their priorities and shift some of their substantial domestic compressor capacity to Yamal or an alternative line at the expense of delaying domestic gas availability. Because Yamal will apparently take only 12% of planned added compressor capacity in the 1981-85 time period (3000 MW out of 25,400), this appears feasible although with a loss of efficiency and probably some delay. (However, the Soviets might be able to start gas exports from Urengoy in Siberia before the completion of Yamal by adding a segment to a new "domestic" line being built from Urengoy to Novopskov. This line might be extended to, and through, Czechoslovakia by 1984-85.)

Although, it appears possible for the Soviets to complete Yamal with some delay or even to expect gas early via a non-Yamal route, the denial of US technology would nonetheless be costly to the Soviets. By slipping, say, two of the 56" pipelines, Moscow would delay the availability to the domestic economy of the equivalent of about 500,000 barrels of oil/day, about 2% of total energy consumption. Since domestic gas can be and probably is largely intended to replace oil, this gas delay could deprive the Soviets of around $5 billion in oil hard-currency savings.

In short, although we cannot be confident that our sanctions will delay Yamal or a substitute for it, there is a good chance that our sanctions will do one of the following: (a) delay the export of gas capable of earning about $5 billion a year; (b) delay the export of oil of comparative value which would be replaced by domestic oil; or (c) delay the availability of gas to the Soviet economy.

## Grain sales

Section 1204 of the Agriculture and Food Act of 1981 states that any controls on grain except as part of "a suspension or restriction of all" US exports require compensation to producers through 100% parity or direct payments. About 5 million of the 11 million contracted for by the Soviets were not shipped by the end of January. The cost of buying up this grain would be around the ~~$-billion-(check)~~ if it were not part of a complete embargo.

There would be some disruptive cost to the Soviets and they would end up paying a bit more but this cost would not be very substantial.

A different approach to grain sales should be considered, the creation of a grain cartel aimed at the Soviet Union and Eastern Europe. If the US, the EC, Canada, Australia, and Argentina were to impose an export tax on sales to the Soviet Bloc, the effect could be substantial. These four countries of the EC export 90-95% of the grain traded internationally. Although such a cartel would leak and probably eventually break down, a very substantial tax could probably be exacted from the Soviet Union. After three bad harvests, Moscow could not afford to do without this grain; it would pay the price in hard currency; even if it had to sell more gold or curtail other imports. For instance, a $200 per ton tax would have generated this year an additional $7 billion in revenues, assuming 35 million tons of Soviet imports from these four countries. Such a sum might in part be designed for Polish relief -- assuming certain political conditions were met.

## Fertilizers, Pesticides, Other Chemicals

An embargo on these products would have a large impact on the Soviet economy and a small one on ours. Combined with an import embargo, this would sink the twenty year, $20 billion Occidental deal with the Soviets.

## Other Measures

The State paper includes a range of other possible measures including an embargo on all industrial products, all imports from the Soviet Union, revolving licenses of high technology items (including International Harvester combine technology), plus lots of cats and dogs. There is merit in some of these (e.g., stopping the IH deal) but the trouble with the largely symbolic measures is that they are a substitute for truly effective action of the type discussed earlier.